INSIGHT

MANCHESTER
CAPITAL MANAGEMENT, LLC

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INSIDE THIS ISSUE:

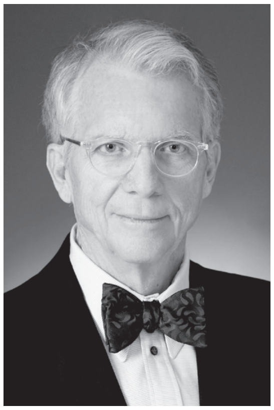
THE MARKET EVERYONE HATES

by Ted Cronin, *Chairman of the Investment Committee*

Almost no one believes in the current equity markets, either here or abroad. The press is full of talk about a bubble, and the apparent disconnect between the health of the economy and the upward march of stock prices. Unemployment remains high, economic growth is below par, China's growth has slowed dramatically, resource prices have fallen off a cliff, and corporate earnings are roughly flat, with little top-line growth. Yet as the recent retail numbers suggested a miserly Christmas season, the markets hit new highs.

The popular view that the stock market is overpriced ignores some fundamental financial truths. Interest rates have been held so low by the Federal Reserve that bonds and cash are very unattractive investments. Indeed, they are dangerous, with the potential for significant losses should the Federal Reserve release their hold on rates by eliminating their stimulus efforts. Investors are being intentionally forced to turn their attention to stocks.

Those investors who still feel the scars of 2008 have missed this year's stock advances, and now are trapped—they feel both the pain of missing an opportunity and the fear of jumping in at a possible high. It's only natural to be angry.



The market advance, however, represents an expansion of multiples, the increase of productivity, and the cutting of costs (especially labor). History has shown that when the markets experience this kind of momentum, it continues for multiple years. We are certain to have interim declines, but the evidence is in favor of a longer bull run than many anticipate.

Certainly a significant change in Federal Reserve policy could undermine the stock market globally, but the recent appointment of Janet Yellen as Chair bodes well for a continuation of holding the short-term rates near zero. If the Federal Reserve stopped buying long-dated bonds, it would trigger a market retreat, but one likely to be short lived. The Federal Reserve is set on a policy of not releasing control of rates until there is sufficient economic growth to sponsor strong corporate earnings. That is a ways down the road.

Another signal that the markets are more likely to advance than decline is the recent evidence that retail investors are finally beginning to join the party. They, and poorly managed institutions, have a hoard of cash to invest, and we are unlikely to suffer a sustained bear market until everybody is on board the market train. We need widespread agreement that the stock market is a sure bet before it is likely to falter.

Another interesting indicator of the future health of the market is the breadth of the advance. Baseline Analytics recently pointed out that 73% of the stocks in the S&P 500 are above their 50-day moving average. Market bubbles are typically characterized by one sector dominating the averages, such as technology (in 1998) or banking (in 2006). Currently the market gains are spread throughout the sectors, with the number of new highs evenly spread across the averages. The S&P is currently trading at around 15 times earnings, which is well below the 25 times that the S&P reached during the technology bubble.

An unfortunate consequence of current conditions is the growing disparity between the wealthy and the poor. Those with capital at work in the stock markets are reaping significant rewards, while the government policy of keeping rates low has failed to stimulate the economy and spur rapid job growth. Companies hoard cash, flood the bond market with new issues, and limit capital investments to more efficient technological solutions rather than labor.

> The stock market here and abroad is likely to continue to advance for a while.

Americans might well enjoy a “manufacturing renaissance” ignited by the low cost of energy and increased computer-driven production by robotic devices. Labor participation rates could continue to fall, disguising the fact that the decline in the unemployment rate is really a decline in working middle class. That is perhaps the real reason to hate the current market advance. It represents a real measuring stick of the growing disparity of wealth.

The stock market here and abroad is likely to continue to advance for a while. Its appreciation dictates some appropriate rebalancing of portfolios, but only a major change in government policy will derail this train. The market could suffer from an exogenous event, such as a nuclear or natural disaster, but barring such catastrophic events, there are likely only three ways to change the current course.

One, the Federal Reserve could stop holding short-term rates near zero, allowing inflation to begin to accelerate to a point where it destroys the value of money. Two, the government could adopt a punitive tax policy that would alter the deployment of capital. Or three, the current suppression of the economy could extend to a point where we enter a deflationary period akin to the one Japan suffered for decades.

None of those scenarios are attractive or likely. We are alert to making adjustments if any of these alternatives unfold. In the meantime, we have mixed emotions about the markets, both enjoying the gains and watching with despair the negative impacts on our country.

WHAT THEY WILL NEED TO KNOW

by Kristina Koutrakos, *Managing Director*

Last year, one of our board members came to us with a problem—his brother had fallen quite ill and his estate was indecipherable to his family. Locations of deeds, status of wills, copies of trust documents were all unknown. In the midst of dealing with his sickness, the added stress of trying to make sense of estate matters was putting an unnecessary tax on his health. Our board member asked if we could put together a list of estate documents that should be sorted out in an attempt to help alleviate some of the strain on his brother and his family.

In handling this request, we truly came to appreciate the vast quantity of information, desires, and details that accompany this time of life. The planning required is onerous, especially if dealt with in the midst of other events. The task quickly brought to life the need for a tool to assist our families with this process.

We have compiled a document titled "What They Will Need To Know" in an attempt to provide a single source for those items necessary in planning for your estate. It includes not only a list of important legal documents, but things such as beneficiary designations, memorial wishes, online networking access, health records and documents, and a variety of other items to help families sort through the complications and decisions surrounding a loved one's estate. Most importantly, it is designed to mitigate the stress of such trying times.

"What They Will Need To Know" is an attempt to lend a hand and help families through difficult transitions. It is not all-encompassing and some of the details will not apply to everyone, but it should suffice in organizing your affairs in a thoughtful and planned manner. More than anything, it can be seen as a gift that you give to your family when they will need it most. We hope that it will help you, and your loved ones, prepare and plan now for events that, fingers crossed, will not occur for many, many years.

Please feel free to contact any of our offices for a copy of "What They Will Need To Know." You, your friends and family may also download it at any time from the Manchester Capital website (www.mcmllc.com). Please feel free to share the URL with anyone who may need such a document.

INFLATION

"Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output. ... A steady rate of monetary growth at a moderate level can provide a framework under which a country can have little inflation and much growth. It will not produce perfect stability; it will not produce heaven on earth; but it can make an important contribution to a stable economic society."

– Milton Friedman,
The Counter-Revolution in Monetary Theory (1970)

DON'T BET THE (VIRTUAL) FARM ON BITCOIN YET

by Bart Earley, CFA, CFP®
Managing Director of Research

There has been considerable talk about the implications of the Federal Reserve's policies on the economy, inflation, and the sanctity of the U.S. dollar as the world's reserve currency. If, as Milton Friedman said, inflation is always and everywhere a monetary phenomenon [see sidebar], the Federal Reserve's quantitative easing programs should be wildly inflationary. From the end of 2008 through September of this year, U.S. gross domestic product has increased 16.1%. Over the same period, the money supply (M2) has expanded 30.2%.

While the uncertainty created by such a rapid monetary expansion has led some to search for other currencies as a means of safeguarding wealth, safe havens are hard to find. All fiat, or government-issued, currencies are subject to the whims of the current ruling government. Normally, the stabler the government, and stricter the body of currency regulations, the stabler the currency.

As a hedge against fiat currencies, others have turned to gold, the world's oldest currency. Used for thousands of years as a medium of exchange, gold is widely accepted by financial institutions, but does have its drawbacks. Heavy to carry and difficult to subdivide, gold also has some price-stability issues. With no government body intervening in world gold markets, gold's price is set by the marginal investor, and during 2013 the price plummeted.

Enter Bitcoin, the 2009 brainchild of Satoshi Nakamoto (a pseudonym). Not just a currency, Bitcoin is also an online financial network—a way for individuals to send payments peer-to-peer without transacting in dollars, euros, pounds, or yen and without going through a financial institution. The software code is open-source and decentralized, relying on transparency and a global network of participants rather than a third party to maintain the system. Bitcoins are stored in digital "wallets" and linked to an address—a long string of letters and numbers—where a private cryptographic key is required to access the Bitcoins.

New coins are created by solving complex mathematical problems through a computing process called "mining." Once created, the new coins can be spent or transferred, with each transaction recorded in a shared public ledger, called a "block chain," and verified by the network of Bitcoin miners to ensure system integrity. There are currently 12 million Bitcoins in existence; the maximum is set at 21 million, per the original software code.
Since Bitcoin is not backed by any central authority, rather the faith

of its user community, its value as a form of currency is speculative. Its proponents suggest Bitcoins have value based on the properties of mathematics, but as with gold, the marginal investor sets the price and Bitcoin's value depends on the willingness of others to accept them as payment. Bitcoins' price, has experienced severe price fluctuations, and movements of $100/day in either direction are not uncommon.

So why is this speculative digital currency/payment system getting any attention? Why has the value of each Bitcoin increased from $0.30 back in 2009 to more than $1,000 in 2013? Perhaps it's because Bitcoin offers a little something for everyone.

- *Free Market Libertarians:* No Federal Reserve to manipulate the currency value and completely free from government control.

- *Techies:* Puts the power to create money (mine Bitcoins) in their hands through raw computing power. One now requires ASIC hardware, roughly 50 times more powerful than FPGA, to compete in a system with computational capacity of 5 quadrillion hashes per second. Beware—some have developed malware to hijack personal computers in an effort to increase their computing mining power.

- *Wall Street:* Bank of America lent Bitcoin some credibility (or lost some of its own) when a BofA analyst initiated coverage of Bitcoin as a "buy" with a $1,300 price target. For retail brokers, Bitcoin offers another product to sell.

- *Criminals:* The Silk Road, an online marketplace used for illegal drug activity, accepted payment only in Bitcoins and was shut down by the U.S. government. With the number of Bitcoins ultimately issued capped at 21 million, the temptation for hackers and tech wizards to try to steal or counterfeit coins will be enormous.

- *Hedge Funds:* A Malta-based fund called Exante claims it's up nearly 5,000% in 2013 investing exclusively in Bitcoin. The fund charges a 1.75% management fee and a 0.50% transaction fee.

- *Venture Capitalists:* Lightspeed Venture Partners of San Francisco has an investment in BTC China, the largest Bitcoin exchange in the world.

And some further out there:

- *Tiny Countries No One Has Heard Of:* A three-mile-long island under the British crown called Alderney (population 1,900) wants to mint physical Bitcoins, composed in part of gold, backed by electronic Bitcoins. Holders of the Alderney Bitcoin would not be able to spend the physical coins, but would be able to exchange them for electronic Bitcoins by traveling to the island nation (off the northern coast of France, 200 miles northwest of Paris).

- *Newspaper Editors:* When small islands no one has ever heard of dream up silly schemes involving Bitcoin, it gives major newspaper editors something to write about (see the *Financial Times*, 11/29/13).

- *Electric Avenue:* In December, a $100K Tesla electric car was purchased from a California dealership using 91.4 Bitcoins.

- *Garbage Pickers:* It was reported that a Wales man accidentally threw away his hard drive containing 7,500 Bitcoins (currently worth $8 million) and it now sits under four feet of garbage in a landfill. The IT professional mined them in 2009 a few months after Bitcoin's launch, but ceased when his girlfriend complained the laptop running the mathematical algorithms was too noisy.

- *Rich Guys in Space:* Sir Richard Branson proudly announced on CNBC that he will accept Bitcoins for flights on his Virgin *Galactic.*

Clearly, the electronic equivalents of cash are growing—witness both devices attached to cell phones in order to allow credit cards to be swiped and businesses that accept payments directly from smartphones (usually using bar-coding systems). With the introduction of Apple's biometric (fingerprint) identification systems, the rate of growth will probably accelerate. Beyond convenience, there is attractiveness to having a single currency that could span continents and cultures, one free from government interference, manipulation, and political influences. Someday its time will come. But don't look for Bitcoin in your portfolio quite yet.

2014 GLOSSARY

Here are five technologies that you will hear more about in 2014:

Bitcoin

An online, digital currency (see article on page 4 for details)

www.bitcoin.org

Pinterest

An online corkboard that allows members to "pin" and share crafts, recipes, images, or links on their "pinboard"

www.pinterest.com

Square

A small, white, square reader that attaches to your phone to accept credit card payments

Squareup.com

SnapChat

A photo messaging service that allows users to send images to each other that disappear after a few seconds

www.snapchat.com

zulily

Daily shopping deals for "moms, babies and kids"

www.zulily.com

VALUES AND CULTURE

by Read Cronin, *Managing Director*

The culture and values of any company dictate how it conducts its affairs, cares for clients and staff, and structures its business model. Less tangible than the dollars and cents of bottom-line profitability, a firm's ethos can often have as great an effect on the firm's future and longevity. Though hard to define exactly, culture and values are frequent topics during year-end staff reviews, when each employee is graded on how they have upheld and contributed to the values and culture of the firm.

Of the myriad values Manchester Capital esteems, we hold three as key tenets of our foundation: integrity, authenticity, and commitment.

Integrity

Honoring our word to others in order to honor it to ourselves and thereby define our own character. Our personal honesty is core to how we relate to our colleagues and, above all, to our clients. A telltale sign is that personal self-confidence is paired with humility, and bravado and self-aggrandizement are absent. Clients and coworkers will recognize the difference as quickly in us as we do in others. Having integrity means facing harsh realities without worrying about looking good. It means being willing to discover, confront, and expose our failings. It means putting achieving client and firm goals before personal objectives and ego.

Authenticity

Confronting the truth of who we are and dropping the facade of who we might wish to be. Authenticity is simultaneously the most difficult trait to achieve, the most painful to accept, and the most liberating. Authenticity includes not being afraid of making errors. At Manchester Capital, we strive to create a culture in which it is acceptable to make mistakes but unacceptable not to own, identify, analyze, and learn from them. We always put the clients' needs ahead of our own and act as their advocate in the management of their wealth. We respect everyone's opinion and respect their beliefs. We seek out critical feedback from our colleagues so that we can improve in the performance of our duties.

Commitment

Willingness to expend the energy, time, and effort necessary to achieve client success. Long days, interrupted schedules, and missed pleasures are sacrifices we willingly make to client and company.

Through integrity, authenticity, and commitment, we strive to make the whole of Manchester Capital greater than the sum of its parts, dedicated to something bigger and able to overcome any challenge.

QUARTERLY REPORTS

by Brian McGunnigle, *Director of Operations*

"Operations" can be used to describe many things within the financial services field. Here at Manchester Capital Management, *operations* means providing clients and wealth managers with the information, service, and support they need. It means developing the operational efficiency behind the scenes to support the tailored solutions delivered to clients, while providing the appropriate levels of quality control, redundancy, and oversight. This largely involves blending the right people, the right technology, and a work atmosphere that encourages excellence.

Whether by a wealth manager or an operations associate, client contact always has a purpose. When we are conveying information to clients–by phone, email, or regular mail–that information needs to be accurate, timely, and consistent across all mediums. Additionally, what clients hear from the firm between reporting periods should be in sync with what they see on their quarterly reports.

The operations group takes particular pride in Manchester Capital's quarterly performance reports. Unlike traditional brokerage statements that often include an overwhelming amount of information, are difficult to understand, don't include investment performance, and don't tie back to client investment goals, Manchester Capital's reports are designed to provide clients with a consolidated picture of their investment world. We strive to provide the most relevant information available in an easy-to-understand format, either hard copy or electronically, depending on the client's preference. We believe clients should be provided with the information to understand how their assets are being invested, how those assets are performing, and what it is costing them without requiring an advanced degree in higher math.

At Manchester Capital, it is all about the clients. While we are committed to pursuing the best people and technology available to ensure smooth, effective, and efficient operations, we always welcome feedback from our clients and professional partners on how we can do better.

MEANINGLESS PHRASES

J.M. Brown recently reminded us in ***Barron's*** of Wall Street's favorite ways of saying something that means nothing:

"Opportunity Abounds"
— Long-Only Equity Guy

"Stockpicker's Market"
— Active Equity Manager

"Expect Volatility"
— Trader

"On Track"
— Financial Advisor

"Dislocations Exist"
— Hedge Fund Manager

"Headwinds Persist"
— Chief Strategist

"Yes, However..."
— Economist

"Caution Warranted"
— Balanced Fund Manager

"What's Moving?"
— TV Anchor

"Clouds Darken"
— Newsletter Writer

INSIDE MCM

Manchester Capital on Video

You can now see your favorite Manchester Capital employees on video! Please take a look at our website (www.mcmllc.com) to catch up on what we have been focusing on around the business. You can see a firm overview, highlights of our real estate practice, and topical videos on key aspects of our values and culture.

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